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EFFECTS OF THE SENKAKU/DIAOYU ISLAND DISPUTE
ON SINO-JAPANESE ECONOMIC RELATIONS

by
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A thesis submitted in partial fulfillment of the requirements for completion
Of the Bachelor of Arts degree in International Studies
Croft Institute for International Studies
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Abstract:

Sino-Japanese relations have long been characterized by the saying "cold politics, hot economics." Poor political relations are an accepted aspect of Sino-Japanese relations, but are good economic relations necessarily the norm? This thesis seeks to question how nationalism and nationalist sentiment in Japan and China affect economic relations following a key "cold political" dispute (the Senkaku/Diaoyu Island dispute of 2012-2013).

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Introduction

Context of the Dispute

China and Japan have a long history of animosity and political tension.

Underlying these predominately political issues has been a relatively stable economic relationship, particularly after normalization in the 1970s when China began to open itself to the world. This relationship led to the characterization of Sino-Japanese relations as “cold politics, hot economics.” Prior to diplomatic normalization in the 1970s, Sino-Japanese relations were strictly economic and typically only existed between the citizens of each country rather than the governments themselves. After normalization, however, this relationship experienced periods of highs and lows that led to the “cold politics, hot economics” characterization, with the “highs” predominately found in the economic sphere and the “lows” found in the political sphere.¹

One of the biggest conflicts in Sino-Japanese relations in the post-normalization era is the territorial dispute over eight small islands and rocks in the East China Sea. Known as “Diaoyu” in Chinese and “Senkaku” in Japanese, these islands and rocks are more than just small specks in a vast ocean. Representing a history of imperialism, war, and nationalism, these islands have been a source of “cold politics” in recent years. As this dispute continues, the question of how a political issue like a territorial dispute could affect economics forms. The history of this dispute itself is multifaceted, and the complexity of it could warrant its own thesis. In order to avoid a long-winded discussion of history and an equally long-winded debate over the ownership of this territory, it is necessary to focus on the key element of nationalism that underlies this dispute, but a

¹ He, Yinan, “The Bitter Legacies of the 1972 Sino-Japanese Normalization Talks”, Wilson Center, 13 March 2017.

timeline of the dispute is provided (see: “Figure 1”) for a brief outline of the historic events that created and affect this dispute.

As the Senkaku/Diaoyu Island dispute has come to the forefront of Sino-Japanese politics, so have higher levels of animosity between the Chinese and Japanese governments. Currently, the United States recognizes Japan as the administrator of the islands and uses the Japanese name “Senkaku” in official releases and statements, but it is the official United States stance to not recognize either side of a territorial dispute as the sole sovereign owner of the territory.² As such, the United States does not recognize Japan or China as the sovereign owner of the islands. In recent years, conflicts involving the islands have taken many forms, but none have reached the scale of the 2012-2013 dispute, which will be the focus of this thesis.

In September 2012, then Japanese Prime Minister Noda Yoshihiko nationalized the islands after the governor of Tokyo threatened to purchase the islands, make them a part of Tokyo, and build upon them. In an attempt to prevent the nationalist governor of Tokyo from gaining control of the islands and potentially upsetting an already shaky diplomatic relationship with China, Noda nationalized the islands.³ Contrary to its intended purpose to maintain the status quo, this action was not taken well by the Chinese government or the Chinese populace. Almost immediately, mass protests in Chinese cities erupted as nationalist tensions over sovereign claims were renewed.

What made the 2012 dispute larger than previous conflicts over the Senakaku/Diaoyu Islands? Historically, this dispute has been limited to affecting political

² This is the current policy of the United States as of March 2017. It cannot be determined that the policy of not supporting one country’s claims to sovereignty over another’s in a territorial dispute will always be the official policy of the United States.

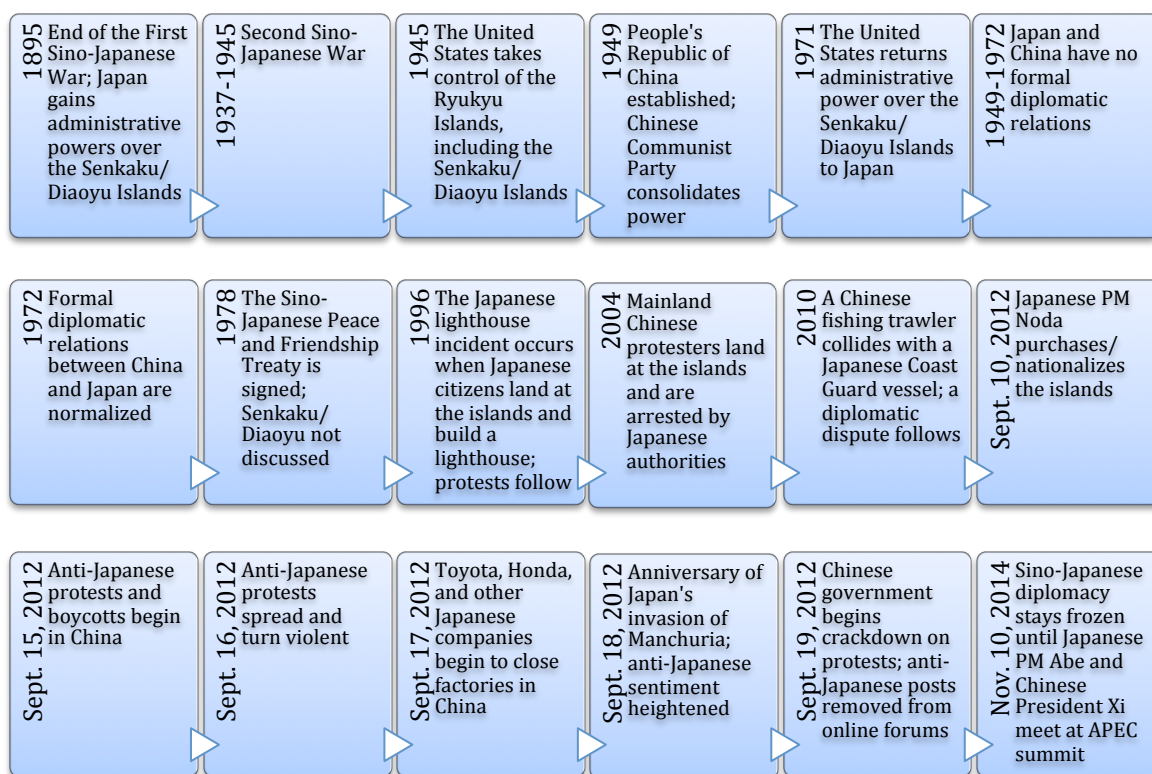
³ “Timeline: the Diaoyu-Senkaku Islands dispute”, South China Morning Post, 18 September 2012.

relations between China and Japan, as it should as a political dispute, but the 2012 dispute had wider reaching implications.⁴ The mass protests in China, due in part to the high levels of nationalism that fueled them, led to a series of negative economic trends.⁵ Beginning with a decrease in bilateral trade following a boycott of Japanese goods, the 2012 dispute eventually led to an economic decline in trade and foreign direct investment (FDI) between China and Japan. For a relationship that long followed the general rule that politics and economics occupy separate spheres, this rapid economic decline called into question the appropriateness of the assessment “cold politics, hot economics” in terms of Sino-Japanese relations.

⁴ Some previous disputes included economic boycotts and protests, but none to the scale of the 2012-2013 dispute, and none so powerful as to endanger the entirety of Sino-Japanese relations.

⁵ Reilly, James, “A Wave to Worry About? Public opinion, foreign policy, and China’s anti-Japan protests”, 2014, *Journal of Contemporary China*, 23:86, p.197-215.

Figure 1: Timeline of Dispute⁶



Literature Review

This section contains a review of existing literature regarding the Senkaku/Diaoyu Island dispute, its effects on Sino-Japanese economic relations, the nationalism that fuels it, and how “cold politics, hot economics” characterizes Sino-Japanese relations.

Individually, the political sphere does not tend to affect the economic sphere, but when the causal mechanism of nationalist sentiment is introduced, the political has the potential to affect the economic. As the causal mechanism linking the political to the economic, nationalist sentiment forms a basis for a majority of this thesis, thus it is

⁶ Information in timeline from: “Timeline: the Diaoyu-Senkaku Islands dispute”, South China Morning Post, 18 September 2012.

important to understand key concepts related to Sino-Japanese nationalism as explained by theorists like James Reilly and Jessica Chen Weiss. As a general rule, I accept and agree with Reilly's theory of cyclical nationalism, also referred to as waves of nationalism or waves of mobilization.

The basis of Reilly's theory is that one small but inflammatory event can snowball into a rapidly spreading nationalist protest.⁷ In his article "A Wave to Worry About?" Reilly states, "When a new unexpected event stimulates popular anger and activism, another wave of mobilization will emerge and the cycle will be repeated."⁸ In this sense, nationalist disputes have no real endpoint because they will continue along this cycle, reemerging with each new stimulating event. This is particularly relevant in the case of Sino-Japanese relations where nationalism has underscored almost every major conflict since the First Sino-Japanese War, but has manifested itself in different ways depending on the political climates in Japan and China at a given time. Reilly uses four events in Sino-Japanese history as the "unexpected events" that led to anti-Japanese protests in China: the 1985 Japanese textbook incident and Yasukuni visit, in which the Japanese government approved textbooks that presented a positive view of Japan's actions during the Second Sino-Japanese War and the subsequent visit to Yasukuni Shrine by the Japanese prime minister; the 1996 Senkaku/Diaoyu dispute, in which Japanese citizens sought to construct a lighthouse on the disputed islands and an activist from Hong Kong died while trying to reach the islands; the 2004 Senkaku/Diaoyu dispute, in which the first group of Mainland Chinese activists successfully landed on the islands; and the focus of this thesis, the 2012 Senkaku/Diaoyu dispute. In each case he

⁷ Reilly, James, "A Wave to Worry About? Public opinion, foreign policy, and China's anti-Japan protests", 2014, *Journal of Contemporary China*, 23:86, p.200.

⁸ *Ibid.*, 201.

presents the anti-Japanese protests as building off the previous events and protests. From the macro level this theory works to show how nationalism presents itself over the long-term in China, but from the micro level it shows how a singular event can increase the volatility of nationalism. In this case, nationalism has underscored Sino-Japanese relations for the duration of the 20th century, but a singular event like the nationalization of disputed islands serves as a catalyst for popular nationalist sentiment.

In Weiss's book, *Powerful Patriots*, Reilly's theory of cyclical nationalism is upheld, but Weiss does not look at it solely through the lens of action/reaction between two countries as Reilly does. Weiss views the overarching way in which popular protest and government action/reaction (both international and domestic) interact.⁹ Like Reilly, Weiss recognizes the cyclical motion of nationalist protests and disputes, but she also notes authoritarian regimes' abilities to control protests when they occur. She looks generally at protests in China that were directed at international powers (be they Japan, the United States, or another country). Where Reilly distinctly states that there is no endpoint to a nationalist wave, Weiss explains that there may not be an endpoint, but China's authoritarian regime is very good at increasing or decreasing nationalist sentiment when deemed necessary. She points out that nationalist protests not only affect China's relationship with other countries, but also the stability of the regime itself.¹⁰ There are various risks and gains to be had by allowing anti-Japanese nationalist protest. This does not recognize an endpoint to nationalist sentiment itself, something even the most powerful of authoritarian regimes would have a hard time controlling, but it does recognize an endpoint to nationalist protest in the short-term.

⁹ Weiss, Jessica C, "Powerful Patriots", 2014, Oxford University Press, p.7.

¹⁰ Ibid., 16-17.

The concepts Reilly and Weiss describe are not mutually exclusive of each other, and both will be accepted in this thesis. In order to understand the Senkaku/Diaoyu dispute of 2012, it is important to understand Reilly's concept of cyclical nationalism as a baseline for how the dispute grew to its 2012 boiling point and how it will develop in the long-term. It is also important to understand the responses of the Chinese and Japanese governments to the protests of 2012, and specifically how the Chinese government tends to react in general to nationalist protests, which explains what happens in the short-term after an unexpected event that sparks nationalist protest. Because Reilly explains how nationalism in general grows and Weiss explains how nationalist protests (specifically in China) grow and contract, this thesis will seek to use both theories as a baseline of nationalism in regards to the dispute itself and nationalist sentiment as it affects protests as reactions to the dispute.

Although this thesis will primarily focus on nationalist sentiment as displayed through Chinese popular protest, it is still important to understand nationalism in Japan. Patrick Hein's essay in *Asian Nationalisms Reconsidered* on Japanese Prime Minister Shinzo Abe's legacy of nationalism provides a good understanding for how nationalism presents itself under Japan's current prime minister. While nationalism has manifested itself in China as popular protest in recent years, Japanese nationalism is much more likely to manifest itself as a position of a few conservative politicians, lacking the mass mobilization that Chinese nationalism possesses. Japanese citizens may hold nationalist views but hardly act on them outside of their votes for nationalist politicians.

Hein uses Abe's book, *Towards a Beautiful Country*, as the basis of his assessments of Abe's nationalist policies, which provide an understanding of the events

that lead to Reilly's waves of nationalism. The most important understanding about nationalism under Abe's leadership is that it has led to what Abe calls "proactive pacifism." Proactive pacifism is essentially Japanese nationalists' desire for the right to collective self-defense, which would benefit Japan's defense partnership with the United States, and through this strengthened partnership, prevent the use of military force.¹¹ Proactive pacifism has been viewed by many of Japan's wartime enemies as a way for Japan to assert military power in a manner that has been unwelcome in Asia since the end of World War II. The important thing to note about proactive pacifism is that, despite being a nationalist policy, the Japanese public has not shown overwhelming support for it, implying that nationalism in Japan is not the same type of populist movement that it is in China. Furthermore, Abe's views on China have changed from the time of the first publication of Abe's book in 2006 to the second publication in 2013 (after the 2012 Senkaku/Diaoyu dispute had played out). In the 2006 edition, Abe is very supportive of furthering Sino-Japanese relations through economic channels, recognizing the very real nature of "cold politics, hot economics", but in the 2013 edition of the book Abe suggests that negotiation may not work and that more forceful methods are needed.¹² This change in opinion is undoubtedly due to the nationalist nature of the 2012 dispute.

Just because nationalism in Japan is not the popular movement it is in China, does not mean that Japan's actions cannot be construed as nationalist by its neighbor and create conflict, as has been suggested by Robert Dujarric.¹³ Dujarric holds that the existing rivalry between Japan and China is created out of the closeness of the U.S.-Japan

¹¹ Hein, Patrick, "Leadership and Nationalism: Assessing Shinzo Abe", *Asian Nationalisms Reconsidered*, ed. Jeff Kingston, Routledge, 2015, p. 85.

¹² Ibid., 89.

¹³ Ibid.

alliance. In his view, because nationalism in Japan is not a popular movement, existing conflict must arise externally from the U.S.-Japanese alliance, which given the history of Sino-Japanese conflict outlined previously (see: “Context of the Dispute”), is clearly an oversimplification that does not account for unexpected or accidental events or the historic events that have created an environment of animosity.¹⁴ Japan may not actively seek to exert force over its neighbors as it did in the past, but Japan cannot control how its neighbors construe its actions, thus an unexpected event can always create a new wave of nationalism.

Now that an understanding of the existing literature involving nationalism in China and Japan has been reached, it is important to understand what existing literature has to say on the “cold politics, hot economics” characterization of Sino-Japanese relations. In his essay, Li Mingjiang focuses on how “hot economics” has prevented “cold politics” from turning into “freezing politics”.¹⁵ This is a traditional way to look at the “cold politics, hot economics” relationship and a fairly traditional view held by many political realists. Good economic relations prevent poor political relations. This thesis will look at this relationship from the opposite angle: how “cold politics” affects “hot economics,” or more simply, “how does the political affect the economic?” Li states that there is a fear the political might affect the economic, but it is not the focus of the essay.¹⁶

The strength of Li’s essay comes in the form of explaining why “cold politics” exists between China and Japan and explaining how political events build off each other in each country. For instance, an increase in military spending in China may lead to Japan

¹⁴ Reilly, “A Wave to Worry About?”, 201.

¹⁵ Li, Mingjiang, “China and Japan: Hot Economics, Cold Politics?”, *Japan’s Strategic Challenges in a Changing Regional Environment*, ed. Purnendra Jain, World Scientific, 2012, p. 55.

¹⁶ Ibid.

strengthening its defense agreement with the United States, or a visit of the Japanese prime minister to Yasukuni Shrine may be construed as a nationalist action by China.¹⁷ The problem with Li's essay is that he accepts the general truth of "cold politics, hot economics" as a characterization of Sino-Japanese relations. This problem fundamentally stems from the fact that Li views economics as the factor that prevents bad political relationships, instead of looking at how politics affects economics. As a matter of fact, Li believes that a scenario of "cold politics, cold economics" is unlikely, but in describing this scenario, he describes what Sino-Japanese relations began to look like during the 2012 Senkaku/Diaoyu dispute.¹⁸ The view that economics is a preventative in declining Sino-Japanese political relations is questioned extensively in his essay.

This thesis will not be the first to question the traditional view of "cold politics, hot economics." In a 2006 essay, Christina Davis and Sophie Meunier questioned the way in which political tensions may affect bilateral economic relations, particularly in regard to trade and FDI (as this thesis does). At the time, a few possible hypotheses were presented, and it was determined that politics and economics occupied separate spheres and thus, political relations did not significantly affect economics between Japan and China.¹⁹ This thesis will serve as a necessary update to this theory, which upheld the traditional view of "cold politics, hot economics." In determining that politics does not affect economics, Davis and Meunier state that there is a threshold in which politics may begin to affect economics, but that threshold is very high.²⁰ If that threshold is met or surpassed, economic interdependence may decrease, and businesses may insulate

¹⁷ Ibid., 57-58.

¹⁸ Ibid., 60.

¹⁹ Davis, Christina and Sophie Meunier, "Business as Usual: Economic Responses to Political Tensions", Princeton University, 2006, p. 31.

²⁰ Ibid., 32.

themselves from further disruption.²¹ As this thesis will show, that threshold may have been met in 2012. This thesis will differ from that of Davis and Meunier's in a few key ways. Not only will this thesis be more recent, but it will also use a political dispute that is much larger in scope and has deeper nationalist ramifications than that of Japanese prime ministers' visits to Yasukuni Shrine, which although a symbol of nationalism and Japanese militarism, is not viewed in the same way as a territory claimed by two countries with a history of antagonism.

Methodology

Historically, most people have viewed “cold politics, hot economics” through the lens of how economic relations prevents cold politics from becoming freezing politics, or they view politics and economics as separate spheres that do not impact the other, but this thesis seeks to look at this question from a different angle: what effect, if any, does a cold political relationship have on economics?²² This thesis will not question whether cold politics between China and Japan exist. As a general rule, we accept that the political relationship for numerous historical and cultural reasons is cold, but it is also recognized that sometimes the relationship is colder than other times. In these instances of heightened political coldness, for instance in the 2012-2013 Senkaku/Diaoyu dispute, heightened levels of nationalist sentiment are also present. For this reason, nationalist sentiment will be used as the causal mechanism that links the political to the economic. In order to gauge nationalist sentiment a scale will be determined that appropriately

²¹ Ibid., 12.

²² Katz, Richard, “Mutual Assured Production”, *Foreign Affairs*, Jul/Aug 2013, 92:4, p.18-24.

characterizes what levels of nationalism exist at different times which will allow for a deeper understanding of how the political affects the economic (see: “Figure 2”).

In this thesis I will answer the questions of what effects the political Senkaku/Diaoyu dispute has on the economies of Japan and China. Anytime the effect of politics on economics in Sino-Japanese relations is questioned, there is an inherent judgment being made about the “cold politics, hot economics” framework. Although this judgment is not the sole focus of this thesis, the reader should bear in mind that as the effects of the 2012-2013 dispute on economics are presented, this binary characterization may appear to be less and less appropriate. Given the economic nature of this topic, at times it may be necessary to present key quantitative economic figures; however, in order to avoid a thesis that is full of numerical charts and data sets that hinder a deeper understanding of a territorial issue, most quantitative data will be presented as statistics or, in some cases, given a corresponding graphic to make the data easier to process. This will make the dispute, which due to its historical complexity cannot be viewed through numbers alone, much more understandable on the whole.

The goal of this thesis is to take the existing literature described above (see: “Literature Review”) and analyze and synthesize it into one cohesive thesis that accounts for political actions, economic actions, and the nationalism that often fuels them in China and Japan, specifically after the 2012-2013 Senkaku/Diaoyu dispute. Up to this point, authors have tended to break up “cold politics, hot economics” and nationalist sentiment, but it is my firm belief that these two concepts necessarily go hand-in-hand, especially as nationalist sentiment snowballs and builds off previous incidents that fueled nationalist fervor. Furthermore, most authors do not question the validity of “cold politics, hot

economics.” They accept this binary’s absolute truth, but in order to understand the effect a territorial dispute can have on the economies of Japan and China, it is necessary to question the characterization of their political-economic relationship. Any time the effects of politics on economics in Sino-Japanese relations is questioned, a judgment is necessarily made about “cold politics, hot economics” as a characterization is made, whether explicitly stated or not. As stated previously, this judgment is not the sole or even main goal of this thesis, but it is imperative that the reader bear in mind that this binary is a massive oversimplification of a highly complex issue.

Glossary

The pace at which the Senkaku/Diaoyu dispute of 2012-2013 escalated and took effect on Sino-Japanese relations was quite fast. Within months, the effects upon Japan and China’s economies were noticeable. As such, it is essential to understand some key concepts and important terms. Additionally, some terms may be Chinese or Japanese and may require an English definition. For these reasons, a simple glossary of important terms has been added for the benefit of the reader.

Cold Politics, Hot Economics: refers to the popular characterization of Sino-Japanese relations after diplomatic normalization in the 1970s. “Cold politics” refers to the strained diplomatic ties between China and Japan’s governments. “Hot economics” refers to the state of economic relations between China and Japan, which are typically very good and include a high trade volume and high amounts of investment.

Freezing/Frozen Politics: not to be confused with cold politics, “freezing/frozen politics” refers to the specific instance in which all diplomatic ties are cut between two countries, diplomatic communication comes to a standstill, embassies and consulates remain open, but diplomacy (especially at higher levels) stops.

Nonexistent Politics: nonexistent politics goes a step beyond freezing to explain the complete lack of diplomatic relations between two countries.

Nationalism: in the context of this thesis, “nationalism” will be nearly interchangeable with the Chinese word *aiguo zhuyi* (爱国主义) which is usually translated to English as “patriotism”. In this context, “nationalism” will refer to the superiority of one nation/country over another (in this case, China or Japan).

Dual Natured Nationalism: The framework used in this thesis that explains how nationalism presents itself in the long-term and the short-term, simultaneously.

Long-term/Macro Level Nationalism: the form of nationalism in the dual natured nationalism framework that underlies every event in Sino-Japanese relations; creates the basis of most disputes (ex. Yasukuni Shrine as a symbol of Japanese militarism).

Short-term/Micro Level Nationalism: the form of nationalism in the dual natured nationalism framework that occurs as a reaction to an event that was created out of long-term/macro level nationalism (ex. a Japanese prime minister visiting Yasukuni Shrine and Chinese citizens responding with increased nationalist public opinion or a protest)

Popular/Mass Protest: simply refers to an organized protest of the citizens of a nation.

A “popular/mass protest” is typically an organic movement that begins within the citizenry of a nation/country and is often rooted in nationalist sentiment.

***Dizhi Rihuo* (抵制日货)**: Chinese for “boycott Japanese goods/products” ;
a popular slogan during the 2012 mass protests in China.

***Za Riben Che* (砸日本车)**: Chinese for “destroy/smash Japanese cars” ;
a popular slogan and activity during the 2012 mass protests in China.

Yasukuni Shrine (靖国神社): A Shinto shrine located in Tokyo that is
the resting place of Japan’ s war dead; because some of the enshrined
are Class-A war criminals, visits to Yasukuni by Japanese politicians
are seen as supportive of Japan’ s nationalist history.

***Gaige Kaifang* (改革开放)**: China’ s “reform and opening” policy set
in place by Deng Xiaoping in 1978; opened China to foreign markets.

Japanese Textbook Incident: An incident occurring in the 1980s in
which the Japanese government approved textbooks that depicted Japanese
imperialism and militarism during the Second Sino-Japanese War favorably.

Short-term: within 1-2 years of an initial event.

Medium-term: 3-4 years after an event.

Long-term: anything after five years following the initial event.

Chapter 1: How Nationalism Shapes the Dispute

Nationalism has taken many forms in Sino-Japanese relations. In order to understand what links the political to the economic in the characterization “cold politics, hot economics”, it is essential to understand how nationalism shapes a dispute like the Senkaku/Diaoyu dispute. This means not only understanding how nationalist actions and histories escalate the dispute but also how nationalist sentiment shapes the reactions to the dispute. This chapter will look at how exactly nationalism links the political and economic by looking at the dispute itself, the reactions to the dispute, and comparing the 2012-13 Senkaku/Diaoyu incident to previous disputes in Sino-Japanese relations.

Pre-2012 Disputes in Sino-Japanese Relations

While it would not be impossible, it would be largely unnecessary to outline every nationalism-based dispute between China and Japan prior to 2012. It is not necessary to discuss in depth anti-Japanese nationalism in China as a method for the CCP to maintain domestic support²³ because this would lead to a tangent on the history of Sino-Japanese relations that is ineffective in this thesis. It is equally unnecessary to discuss how Japanese leaders evoke memories of the height of Japanese nationalism by visiting Yasukuni Shrine where Class A war criminals from World War II are enshrined²⁴, but these types of events do need to be recognized for the way long-term nationalism has shaped them and how, in return, they effect short-term nationalist sentiment in Sino-Japanese relations.

²³ Baker, Rodger, “China Tests Japanese and U.S. Patience”, STRATFOR, 26 Feb 2013, p. 2.

²⁴ Katz, “Mutual Assured Production”, 24.

The complexity of nationalism in Sino-Japanese relations creates two forms of nationalism in China and Japan: the long-term, macro level nationalism that has underscored every major event in Sino-Japanese relations and the short-term, micro level nationalism that presents itself via public opinion and is much more volatile than the long-term form. Events like Yasukuni Shrine visits do not really give the 2012-2013 Senkaku/Diaoyu dispute any comparative value; they only serve as a catalyst for short-term nationalist sentiment and animosity. In order to give the 2012-2013 Senkaku/Diaoyu dispute some comparative value, it is necessary to outline a couple similar disputes leading up to the 2012 conflict. History in Sino-Japanese relations has led to a dual form of nationalism. Moving forward, it is important to note that long-term nationalism shapes disputes, short-term nationalism builds off previous incidents. This dual form of nationalism can be seen when a long-term nationalism allows for a nationalist event to occur, but this event triggers a short-term nationalist response that often involves calls to remember past transgressions.

The pre-2012 disputes analyzed will be used to create a scale of sorts for effective nationalist sentiment (see: “Figure 2”). For this scale we will use “effective nationalist sentiment” because it will allow us to determine the ramifications of the nationalist sentiment at the micro level, as it relates to this dispute in particular. Nationalist sentiment on its own, or ineffective nationalist sentiment, is not enough to create any ramifications in a bilateral relationship. Nationalist sentiment may be present at a given time, but in order to work as a causal mechanism, it must effectively cause some outcome. The pre-2012 disputes this section will look at will be the 1996 Senkaku/Diaoyu incident and the 2004 Senkaku/Diaoyu incident. Long-term nationalist

factors that influence these events will be accounted for when the scale value is applied, but in order to create an accurate scale of the volatile short-term nationalist sentiment involving the Senkaku/Diaoyu problem, previous contestations of this specific territory should be emphasized over other issues.

1996 was one of many heated years for the Senkaku/Diaoyu dispute. Events like the second lighthouse incident (the first occurred in 1990), the process of negotiating the finalized UNCLOS (which was put into effect in 1994), and the death of Hong Kong activist David Chan all contributed to the reemergence of the Senkaku/Diaoyu problem in 1996.²⁵ 1996 was not the first year that the Senkaku/Diaoyu islands were contested, but it did see a large number of protests following the previously mentioned events and led to a spike in short-term nationalist sentiment in both Japan and China. What prevented 1996 from turning into a 2012 scenario were the immediate actions of the Chinese and Japanese governments in response to protest. When David Chan drowned off the coast of the islands because Japanese vessels would neither allow him to swim to shore nor allow his vessel to land, anti-Japanese sentiment in China naturally increased.²⁶ The Chinese and Japanese governments, recognizing the danger an angry, anti-Japanese, populist movement posed to Sino-Japanese relations, immediately stepped in to solve the problem. In China's case this meant cracking down on anti-Japanese media and toning down the coverage of Chan's death.²⁷ The leaders of both countries made sure to visit the other within a year and plans to ensure economic cooperation were taken.²⁸

²⁵ Koo, Min Gyo, "The Senkaku/Diaoyu dispute and Sino-Japanese political-economic relations: cold politics and hot economics?", *Pacific Review*, 22:2, 2009, p. 221-224.

²⁶ *Ibid.*, 223.

²⁷ *Ibid.*

²⁸ *Ibid.*, 224.

The nationalist sentiment found in 1996 did not play out in the same way as that of 2012. Short-term nationalism via public opinion spiked after the initial event, but the economic relationship of China and Japan was never deeply affected. Essentially, “cold politics” existed without really hurting the “hot economic” climate. Using James Reilly’s nationalist wave theory and noting that none of the previous nationalist disputes between China and Japan after Sino-Japanese normalization were debilitating to Sino-Japanese relations in any way, 1996 makes a fairly good base year for comparison to later disputes. If viewed on a scale of 1 to 10 of effective nationalist sentiment, recognizing that 1 would be no effect on relations due to nationalist sentiment and 10 being a level of effective nationalist sentiment capable of causing a war, 1996 would rank somewhere around a 3. Nationalist sentiment was present, as it always is in the long-term form of Sino-Japanese relations, but it was not able to effectively change the relationship between China and Japan, meaning that the short-term form was ineffective; it just raised tensions and reinforced the “cold politics” characterization of Sino-Japanese relations.

2004 was another year that saw a flare up of the Senkaku/Diaoyu dispute. In 2004, a group of Chinese activists successfully landed on the islands. It should be noted that prior to this landing, the Chinese government set up a system of informing the Japanese Coast Guard of attempts to land.²⁹ This system was presumably put in place to avoid a scenario like the 1996 death of David Chan. Knowing this, the 2004 group did not inform the Chinese government of their plans, knowing that they would be stopped.³⁰ After landing, the activists were taken into Japanese custody. When the Chinese government demanded the release of the activists and the Japanese government denied

²⁹ Reilly, “A Wave to Worry About?”, 205.

³⁰ Ibid.

their release, protests outside the Japanese embassy in Beijing ensued and the Japanese flag was burned.³¹ Within a year of the activists being released, high-ranking Japanese and Chinese officials met and established new parameters for the dispute, although they would not agree on the topic of who owed whom an apology for the incident.³² As Reilly notes, “The only sign [of the crisis] was Vice-Foreign Minister Wang Yi’s last minute absence from a signing ceremony for Japanese yen loans to China...”³³ Despite this one seemingly small cancellation, it is important to note that nationalist sentiment was effective in that it established the idea that going through with a previously set up meeting with Japanese leaders would be considered unpatriotic to Chinese protestors.

Again using the theory of nationalist waves, 2004 compounded previous incidents and had larger implications for Sino-Japanese relations. 2004 saw more violent protests than previous years, specifically the burning of a country’s flag outside its embassy, and even if it was just one event, the decision of a high-ranking official to back out of an international trade engagement at the last minute constitutes a change to both political and economic relations. Using the same 1 to 10 scale used to place the effectiveness of nationalist sentiment in 1996, 2004 would constitute something around a 5. Nationalist sentiment was present and managed to affect both political and economic relations to some degree, but the degree was not very large and any effect nationalist sentiment had quickly dissipated following the event, and more specifically, following attempts by the Japanese and Chinese governments to communicate and negotiate problems involving the dispute.

³¹ Ibid.

³² Koo, “Cold Politics and Hot Economics?”, 226.

³³ Reilly, “A Wave to Worry About?”, 206.

Figure 2: Scale of Effective Nationalist Sentiment

1	Nationalist sentiment may be present but has no effect on politics or economics.
2	Nationalist sentiment is present, but its effect on politics and economics is negligible.
3	Nationalist sentiment may lead to protests, but the protests are easily managed and have no lasting effect.
4	Nationalist sentiment leads to protests, which take concerted government effort to resolve, but there are no lasting effects.
5	Nationalist sentiment leads to potentially violent protests that specifically target another nation; political/economic relations may be affected to a small degree.
6	Nationalist sentiment leads to violent protests that specifically target another nation; political/economic relations are affected in the short term.
7	Nationalist sentiment leads to violent protests that specifically target another nation; political/economic relations are affected in the mid term.
8	Nationalist sentiment leads to violent protests that specifically target another nation; the ramifications of nationalist sentiment may last into the long-term.
9	Nationalist sentiment leads to violent protests that not only target another nation, but may call for military action against the other nation; political relations and economic relations become “frozen”.
10	Nationalist sentiment exists at levels found during wartime; countries may engage in war or armed conflict; military action is taken; political and economic relations move from “frozen” to “nonexistent”.

The 2012-2013 Dispute

If 1996 and 2004 were a 3 and a 5, respectively, then where does the 2012-2013 dispute fall on the 1 to 10 scale of effective nationalist sentiment? If we continue to look at micro level nationalism with the nationalist wave theory, then 2012 should have a swell of nationalist reaction that goes beyond any previous incident. After the 2004 incident, the baseline of nationalist sentiment via short-term reactions became a 5. Short-term nationalist sentiment as a public reaction dies out over time after an initial flare, but once a new event occurs that triggers another nationalist reaction, all previous events are used as a baseline. In this case, not only was 2012 a bigger flare because of the higher

baseline of nationalist sentiment, but also because the event that triggered the 2012 dispute was a much larger event: Japanese nationalization of the Senkaku/Diaoyu islands.

In previous incidents of the Senkaku/Diaoyu dispute, the triggering event was usually at a personal level (the death of an individual, individuals being arrested, etc.) and was usually dealt with bilaterally soon after the event (“soon after” here meaning “within a year”). 2012 differed in these respects. In 2012 the action of Japanese nationalization of the islands was viewed by China as a threat to its sovereignty, regardless of what “excuse” the Japanese government might have given to explain the action. In Japan’s view, nationalization with the goal of keeping the status quo was a better option than allowing Tokyo’s nationalist governor to purchase the islands and potentially build upon them.³⁴ In truth, regardless of what Japan’s intent was in purchasing the islands on behalf of the national government, the damage had been done the minute China, and specifically the Chinese populace, heard that Japan had purchased the islands. Long-term nationalism as a historic force created the environment for the dispute to form, and short-term nationalist sentiment allowed for the rapid negative reaction of the Chinese populace. Japan’s miscalculation of China’s response to the purchase opened the door for one of the sharpest declines in Sino-Japanese relations since normalization. In the Japanese view, purchasing the islands meant nothing would effectively change, but in China’s view the nationalization of a territory believed to be theirs changed everything.³⁵

The timing of the event did nothing to help limit the growth of nationalist sentiment as a reaction either. Japan not only nationalized an area viewed as sovereign Chinese territory by most Chinese, but it did so the week before the anniversary of the

³⁴ Weiss, “Powerful Patriots”, 189.

³⁵ Katz, “Mutual Assured Production”, 19.

Japanese invasion of Manchuria in 1931. Long-term anti-Japanese sentiment was already heightened. Furthermore, there was a misjudgment on the part of the Japanese government. Japan assumed that the Chinese government would step in quickly, like it had in the past, to prevent protests from getting out of hand, especially since the 40th anniversary of Sino-Japanese normalization was approaching.³⁶ This was a key misjudgment in the long-term nationalist views of the Chinese government. Timing, misjudgment of reactions, and miscommunication at a national level allowed nationalist protest, especially violent nationalist protest, to flourish for a much longer period of time than any previous incident.

Another factor in play during the 2012 dispute was the widespread use of computers and social media outlets that existed at a level even beyond that of the 2004 incident. Plans for protests could now be spread online and carried out in the same way.³⁷ Essentially, the environment of the 2012 dispute allowed for nationalist sentiment as a reaction to be more heated and spread faster and further than any previous incident. If previous events constituted a wave of nationalism, then 2012 was a tsunami of nationalism, compounded by coinciding long-term nationalist events, the political climate of China and Japan, and higher baseline for short-term nationalist reactions.

After nationalist, anti-Japanese protests expanded to encompass almost every moderately sized city in China, it became obvious that the government would have to step in. Some polls showed that a majority of Chinese felt the Chinese government should take military action.³⁸ Japanese products were boycotted. Japanese businesses and

³⁶ Weiss, "Powerful Patriots", 190.

³⁷ Cairns, Christopher and Allen Carlson, "Real World Islands in a Social Media Sea", *China Quarterly*, March 2016, p. 4-6.

³⁸ Reilly, "A Wave to Worry About?", 209.

cars were destroyed. In one case, a Chinese man driving a Japanese-made car was violently attacked.³⁹ Within a week, the Chinese government stepped in to curb the domestic problems that could have hurt CCP leadership in the long run. What did not happen in 2012 was the immediate response by both governments to set up meetings of high-ranking officials to promote mutual agreements. This omission led to an extended period of frozen politics that went unresolved until November 2014 at the APEC summit in Beijing when Xi Jinping and Abe Shinzo met face-to-face for the first time. While much of the short-term nationalist reactions had died down by 2014, and trade had bounced back to some degree, Sino-Japanese relations were still at an all time low.⁴⁰

This brings back the question of where the 2012 incident ranks on the 1 to 10 scale of effective nationalist sentiment. As will be described in depth in later chapters, the immediate impact on Sino-Japanese economic relations was quite large. The impact on Sino-Japanese political relations was even larger. Using the 1 to 10 scale, the 2012-2013 Senkaku/Diaoyu dispute would probably come in around a 7. If it were not for the Chinese government's ability to curb protest domestically, the issue would have escalated to levels that are dangerous. Not only was nationalist sentiment present, but it went unchecked only until it posed a threat domestically. The boycott of Japanese goods became the manner of protest after the more violent option was exhausted, and where the violent protests exhibited a lot of political nationalism, the boycott was specifically meant to display economic nationalism. A government can put an end to physical protests, but even the Chinese government cannot make people buy Japanese goods.

³⁹ Ibid., 210.

⁴⁰ Heilmann, Killian, "The Effect of International Relations on Trade: Evidence from International Trade Boycotts", 2015, p. 22.

Chapter 2: The Effects of the Dispute on Bilateral Trade

Japanese Dependence on Chinese Markets

Since China's transition from a planned economy to a market economy, Chinese markets have become a force to be reckoned with, both regionally and globally. It seems nearly impossible to find goods that are not marked "Made in China" today. Similar to how many countries rely on Chinese goods, many countries also rely on the sheer size of Chinese markets to sell their own products. Japan is no exception to this seemingly universal rule. After the 2008 financial crisis, Chinese markets were in a relatively stable position. As many markets experienced financial failure, Chinese export markets continued to thrive, and countries that relied upon the Chinese market to sell goods became even more dependent upon the Chinese market. This served to increase Chinese confidence in their own markets, and convinced many of the weakness of other markets.⁴¹

One of the countries heavily dependent upon Chinese exports, and equally dependent upon Chinese markets for the purchase of their own goods is Japan. In 2009, Japan was the second-largest economy in the world.⁴² By 2010, it had been surpassed by China, being pushed into the place of the third-largest economy.⁴³ This change in global economic position did not change Japan's dependence on the Chinese market. Recent statistics show that China and the United States hold approximately equal positions as the largest buyers of Japanese goods (about 18% each, as of 2014).⁴⁴ According to the same statistics, China is singlehandedly the largest source of imports in Japan at 22% of

⁴¹ Li "China and Japan: Hot Economics, Cold Politics?", 59.

⁴² Mt. Holyoke University, "2000 and 2009 GDP Estimates", 2009.

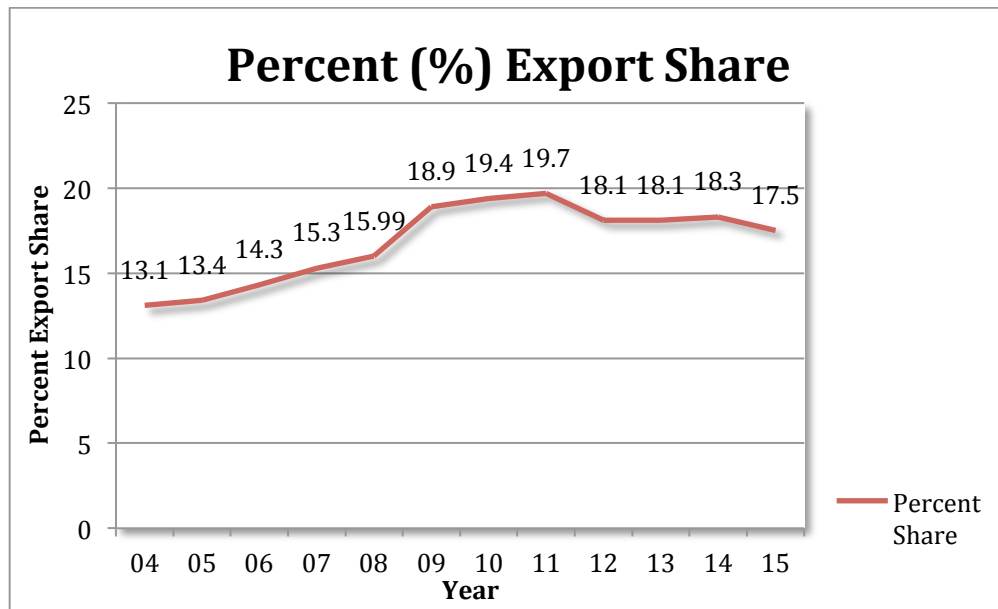
⁴³ World Bank, "Gross Domestic Product 2010", 2010.

⁴⁴ Observatory for Economic Complexity, "Japan", 201.

Japanese imports.⁴⁵ Japanese goods purchased in China are on the decline, however (see: “Figure 3”), and have not reached their pre-2012 levels.

As the largest source of imports in Japan and one of the largest destinations for Japanese exports, Japan’s dependence on Chinese markets is clear, even if in decline after 2012. This dependence has become so evident that many in China believe it cannot be broken. If indeed Japan’s dependence on Chinese markets is as strong as many believe, this would give China greater leverage over Japan.⁴⁶ Whether China’s ability to hold leverage over the Japanese economy is as strong as many Chinese believe or not, there is no denying that in 2012 when the Senkaku/Diaoyu dispute erupted the Japanese economy was heavily dependent upon Chinese markets.

Figure 3: Japanese Export Shares to China: 2004-2015⁴⁷



⁴⁵ Ibid.

⁴⁶ Reilly, “A Wave to Worry About?”, 200.

⁴⁷ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 2004-2015.

Japanese Auto Market in 2012-13: A Case Study

Japanese cars are known worldwide. Brands like Toyota, Honda, Nissan, Subaru, and Mitsubishi are the keystone of the Japanese economy. At 13% of Japan's exports, the automobile industry makes up the biggest portion of the Japanese economy, followed by vehicle parts at 4.7%.⁴⁸ But as the most recognizable symbol of Japan's economic strength and the most recognizably "Japanese" good, the automobile industry is also the first industry affected by country of origin bias. During the Chinese consumer protests of 2012, such a bias became prevalent.

The Chinese mass protests sparked by the Senkaku/Diaoyu dispute of 2012 had one feature that caused them to differ from previous protests related to the dispute: they contained a mass boycott of Japanese goods, especially Japanese automobiles. As the most notably Japanese product, angry protestors began destroying Japanese cars parked in major cities. Indeed, the Japanese automobile industry felt the effects of nationalist protests and boycotts in China.

The mass protests of 2012 took two main forms. The first form was rather violent and involved sayings like "*za Riben che*", meaning "smash Japanese cars" in Chinese. Quite literally, many protestors began to take to the streets and smash Japanese cars with bats, clubs, sledgehammers, or any other object they could find. Nationalist violence directed specifically toward the keystone of the Japanese economy, but in some cases, nationalist violence turned toward those who seemed to support the Japanese economy. In one case, a Chinese man driving a Japanese-made car was attacked and beaten repeatedly, putting him in the hospital with brain damage.⁴⁹ While scenarios like this

⁴⁸ Observatory for Economic Complexity, "Japan", 2014.

⁴⁹ Reilly, "A Wave to Worry About?", 210.

were in no way common during the protests, the destruction of Japanese products, especially cars, was relatively common.

The destruction of Japanese cars led to a common attitude: why spend the money to buy a Japanese car if someone is just going to destroy it?⁵⁰ Naturally, this opinion affected the Japanese automobile industry. Even if people recognized the benefits that might exist in purchasing a Japanese car (safety is often seen as a common benefit), those benefits were all counteracted by the fear that a Japanese car would not be a good investment. Furthermore, country-of-origin bias really took over in late 2012. If purchasing a Japanese car put one at risk of violence, and if driving a Japanese car made one appear less patriotic, then why not purchase a car from a different country? There are plenty of American, European, and Korean substitutes for Japanese brands like Toyota and Honda. This substitutability increases the effect political disputes have on economics.⁵¹ In the end, anger and nationalism combined to enhance an anti-Japanese country-of-origin bias against the Japanese automobile industry.

The second form the protests took was much more civil, and arguably, more productive. While the violent protests were widely condemned by protestors and government officials alike, a civil boycott was not as widely condemned. With sayings like “*dizhi Rihuo*” (boycott Japanese goods), a mass boycott formed. Of course, the boycott included more than just Japanese-made cars, but as stated above, the automobile industry is the keystone of the Japanese economy and thus the most identifiable Japanese product. The success of this boycott stemmed directly from the Chinese government’s ability to crackdown on violent protests. Once traditional protests and riots were ruled out

⁵⁰ From a personal discussion I had with a Chinese professor in Harbin, China (Spring, 2016).

⁵¹ Davis and Meunier, “Business as Usual”, 23.

for those full of nationalist sentiment, the boycott became the best way to voice anti-Japanese, nationalist opinions. It is much easier for a government to crackdown on protestors than an economic boycott.

The three largest automobile manufacturers in Japan (Toyota, Honda, and Nissan) all suffered massive economic losses between 2012 and 2013. 25% of Nissan's sales come from China, 21% of Toyota's, and 16% of Honda's. All three companies had to cut their Chinese production in half by October 2012.⁵² Mitsubishi and Mazda also saw a drop in their Chinese sales.⁵³ Although many of these manufacturers promptly set a timeline for recovery that would occur before the end of 2013, according to some reports, many had to extend that timeline when recovery of sales did not occur as quickly as expected.⁵⁴ Furthermore, if we continue to use the nationalist wave theory, then the next "big event" in Sino-Japanese relations would reignite this nationalist sentiment and have an even larger effect than 2012, meaning that Japanese companies, especially within the automobile industry, must prepare for and guard against the possibility of another economic event akin to that of 2012. This could mean anything from increasing automobile exports to other countries in order to diminish the effects of a future dispute, to actively move away from an unfavorable Chinese market.

Japanese Tourism Market in 2012-13: A Case Study

In a manner similar to that of the Japanese automobile industry, the Japanese tourism industry took a hit immediately following the September 2012 Senkaku/Diaoyu

⁵² Reilly, "A Wave to Worry About?", 214.

⁵³ Ibid.

⁵⁴ Ho, Alexandra and Tian Ying, "Chinese Car Sales Jump 18% as Japan Brands Extend Rebound", Bloomberg News, 10 March 2014.

crisis. Tourism, and in particular Chinese tourism, makes up a large portion of the service industry of Japan. As of 2014, China makes up approximately 22% of Japan's massive tourism industry, holding the number one position of foreign visitors to Japan.⁵⁵ While Chinese tourist numbers in Japan have generally been on the rise, 2012-2013 saw a sharp decrease in Chinese tourist numbers in Japan.⁵⁶ According to one expert, the greatest medium-term damage the consumer boycotts of 2012 caused were in the Japanese automobile industry and the tourism industry.⁵⁷

Much like the automobile industry of Japan, Japanese tourism eventually rebounded, but there is no denying the immediate effects of the Chinese consumer boycott. According to some statistics, All Nippon Airways (ANA), one of Japan's largest airline companies, saw 43,000 cancelled seats from September to November 2012, a majority of which were on flights from China.⁵⁸ Further evidence of the boycott's impact was seen by the 40% drop in Chinese tour group visits to Japan.⁵⁹ Between 2012 and 2013, the number of foreign visitors to Japan from China declined by 110,663 visitors, one of the largest declines in Chinese tourists to Japan on record.⁶⁰

Because there is a judgment to be made on the "cold politics, hot economics" characterization, it is important to note that not only did the Japanese tourism industry eventually rebound, but it did so at much higher levels than previously experienced.⁶¹ However, to say that this rebound is due to a lack in nationalist sentiment on the part of China would be inaccurate. A number of factors led to a rebound in the Japanese tourism

⁵⁵ Kodera, Atsushi, "Tourism emerges as new economic driver for Japan", Japan Times, 24 August 2014.

⁵⁶ Ibid.

⁵⁷ Drifte, Reinhard, "The Japan-China Confrontation Over the Senkaku/Diaoyu Islands – Between "shelving" and "dispute escalation"", The Asia Pacific Journal, 27 July 2014, 12:30:3.

⁵⁸ Reilly, "A Wave to Worry About?", 214.

⁵⁹ Ibid.

⁶⁰ Japan National Tourism Organization (JNTO), "Japan-bound Statistics", 2017.

⁶¹ Kodera, "Tourism Economic Driver for Japan".

industry, among them being resumption of cruise ship tours from China to Japan, the decline of the Japanese Yen, the rise in Chinese household incomes, and even the acceptance of Japan's bid for the 2020 Olympics.⁶² Perhaps the most important factor, the decline of the Yen, made Japan a much more desirable location to visit, especially for consumer tourism, which has always been popular among Chinese citizens who wish to find luxury goods at lower prices than they can at home. The most recent statistics show that "explosive buying" is at an all-time high in Japan, especially among Chinese women between the ages of 20-30 looking for cheaper prices on Japanese cosmetics.⁶³

It was not until 2014 that Japanese tourism really began to rebound from the effects of the 2012 boycotts, meaning that the boycott was quite successful, at least in the short and medium-term. This should not be overlooked when accounting for the effects of this cold political dispute on the economies of China and Japan. It is also important to bear in mind that the return of Chinese tourists to Japan was not due to the fact that the Chinese felt anymore friendly toward Japan, or that nationalist sentiment had declined, but rather because Japan became a relatively inexpensive foreign vacation destination.

Ramifications of the Disruption of Trade

Even though the trade effects of the 2012 boycott did not seem to last longer than a couple years at most, there were certain effects that lasted much longer. When bilateral trade between countries declines, it leads to a decrease in economic stability, mutual trust, and in this case, a renewal of nationalist fervor that affects future disputes. The 2012-

⁶² Drifte, "The Japan-China Confrontation Over the Senkaku/Diaoyu Islands".

⁶³ Ujikane, Keiko, "Chinese 'explosive shopping' boom turns to Japanese cosmetics, supplements", Japan Times, 22 August 2016.

2013 Senkaku/Diaoyu dispute and the ensuing consumer boycott set off a chain of events that can still be felt in China and Japan.

The case of declining economic stability and mutual trust go hand-in-hand. When the consumer boycott began to take effect on the Japanese economy, it became Japan's best interest to find a substitute for Chinese consumers. When Killian Heilman calculated the disruption of trade for the 2012 Senkaku/Diaoyu dispute, he found that the disruption was no longer statistically significant after 12 months, but in the process, he also found that the Chinese boycott had a positive effect on Japanese trade with the United States and Thailand.⁶⁴ The implication of a positive effect on Japanese trade with the United States and Thailand is that Japan, having lost trust in the reliability of Chinese consumers, was able to find a substitute via American and Thai consumers, who were willing to buy Japanese goods. Japan's trade statistics further emphasize that Japan found other countries capable of substituting the Chinese loss. Between 2011 and 2013, China's share of Japanese exports declined from 19.7% to 18.1% (see: "Figure 3"). In the same time, Thailand's share of Japanese exports increased from a 4.6% share to 5.5% share.⁶⁵ This form of substitution is not all together unusual for a country where bilateral trade has been affected by a political dispute. It makes sense that the volatility of Japanese trade with China increases the desirability of other, more reliable, trade partners, which in 2012 appeared to be America and Thailand.

The substitution of Chinese consumers is not only seen in the export of material goods, but also within Japan's tourism industry. Japan has had a long-running "Visit Japan" campaign that has attracted tourists from around the world to Japan. Despite the

⁶⁴ Heilmann, "The Effect of International Relations on Trade", 21-22.

⁶⁵ Japan External Trade Organization (JETRO), "Japanese Trade and Investment Statistics", 2004-2015.

decline in Chinese tourists in 2012 and 2013, Japan's tourism industry has remained steadily on the rise since the beginning of the campaign in 2003.⁶⁶ This means that the decline in one country's tourists did not make any sweeping changes to the tourism industry of Japan as a whole. In 2013, the Japanese government also relaxed visa requirements for visitors from Thailand and Malaysia, allowing for easier entry to Japan for people from those countries, and substituting the loss of Chinese tourists that occurred around the same time.⁶⁷

The substitution of Chinese consumers has a couple of key implications. First, the commonly held sentiment among Chinese nationalist protesters that Japan is heavily dependent upon China and its consumption is not entirely true.⁶⁸ Second, despite substitution, or maybe because of it, China and Japan's economic relation is not as strong as would be implied by overly simplistic characterization of "hot economics." Lower Japanese dependency on Chinese markets than expected means that the Chinese consumer boycott of 2012 and 2013 was not as successful as planned by protesters in the grand scheme of changing Japanese policy by bending Japan to China's will. The decrease in dependency on Chinese markets, in conjunction with the protection from future disputes provided by other trade partners, leaves the notion that, while Sino-Japanese bilateral trade may rebound, their partnership is not as strong as formerly thought. This directly relates to the theory that Davis and Meunier said did not exist in 2006: one in which political tensions lead to a decrease in economic interdependency.⁶⁹ If

⁶⁶ Koderu, "Tourism Economic Driver for Japan".

⁶⁷ Ibid.

⁶⁸ Li, "China and Japan: Hot Economics, Cold Politics?", 59.

⁶⁹ Davis and Meunier, "Business as Usual", 12.

this is the case, political and economic spheres may no longer be completely separate in Sino-Japanese relations, changing the relationship all together.

Return to “Normal”?

The 2012-2013 Senkaku/Diaoyu dispute established a new normal when it comes to bilateral trade between China and Japan. Industries like the automobile industry and the tourism industry eventually bounced back to levels that, in some cases, are better than before the 2012 dispute, but total trade in terms of imports and exports between Japan and China has yet to return to its pre-dispute levels (see: “Figure 4”).⁷⁰

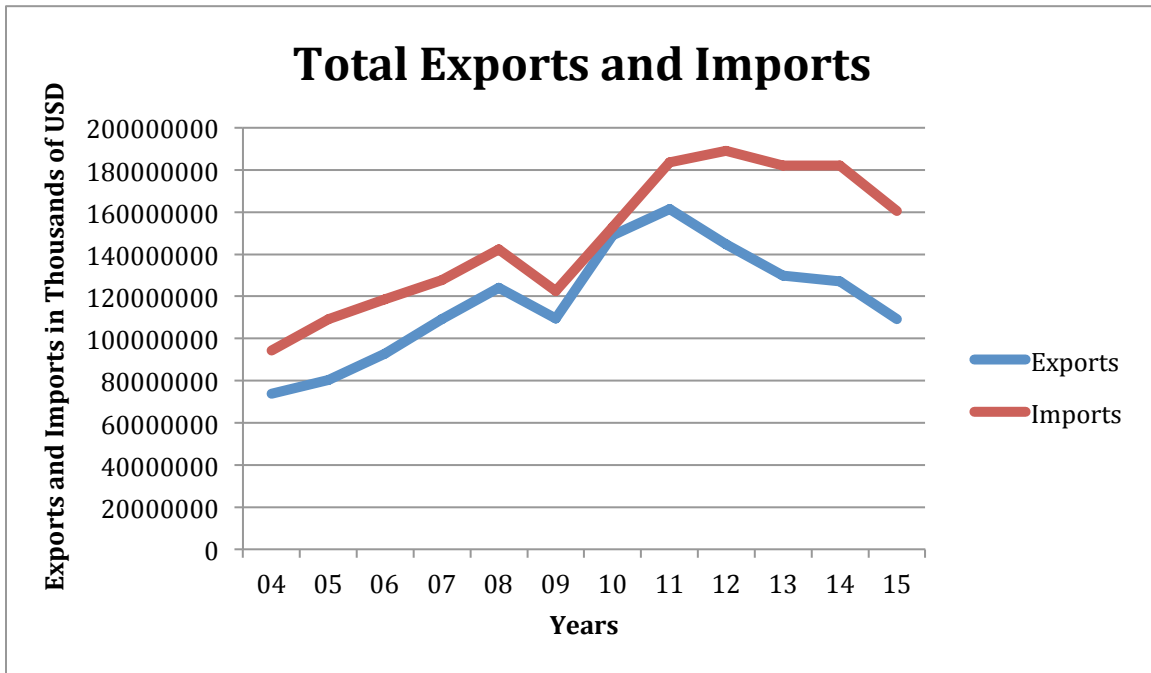
Furthermore, in terms not purely numerical, the 2012-2013 dispute represented a new normal for Sino-Japanese trade. While it may have been true that Japan needed Chinese markets in 2008 and 2009 after the global financial crisis put them in a recessionary position, by 2012 the Japanese were able to prove that Chinese markets were somewhat replaceable. Japan guarded against the ongoing dispute and future disputes by substituting Chinese consumers with others. The mass Chinese consumer boycott presented an initial economic shock, but it was a shock that was overcome through substitution. This substitution made Japan less dependent on China and more dependent on other countries, guarding Japan against future conflicts with its neighbor.

Returning to the scale established in Chapter 1, in which effective nationalist sentiment was measured in the outbreaks of the Senkaku/Diaoyu dispute, the 2012-2013 conflict was determined to be about a 7. Knowing that nationalist sentiment moves cyclically, the new normal for bilateral trade also changed in this regard. Where “normal” once meant a starting point of 5, “normal” after the 2012-2013 dispute became a 7. This

⁷⁰ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 2004-2015.

means that the new normal for Sino-Japanese trade relations is one in which the impact of nationalist sentiment is much wider-reaching and the codependence on each others' economies has lessened to reduce future impacts. If anything, this suggests that, at least in terms of bilateral trade, "hot economics", even considering its relatively stable position years after the dispute, may be an inappropriate characterization for Sino-Japanese economic relations, but further evidence in other economic activities must be provided to determine if this is actually the case.

Figure 4: Japanese Exports to and Imports from China: 2004-2015⁷¹



⁷¹ Japan External Trade Organization (JETRO), "Japanese Trade and Investment Statistics", 2004-2015.

Chapter 3: The Effects of the Dispute on Foreign Direct Investment

History of Japanese Investment in China

In 1978, China implemented a new “reform and opening” policy (known as “*gaige kaifang*” in Chinese) aimed at opening China and its economy to the outside world and moving away from the planned economy of the Maoist era. With this new policy came new markets and new investors. Japan, having experienced its “economic miracle” in the 1960s, was in a position to provide aid and investment to China in the late 1970s.⁷² Japan has long considered itself one of the earliest investors in China following China’s 1978 reforms, and from a strategic standpoint, it makes sense for Japan to invest in its neighbor.

The 1978 “reform and opening” policy opened the door to foreign investment; but it also allowed for a new system of aid, not strictly considered “investment”. In order to understand the future of Japanese investment in China, it is important to understand this form of aid, known as “official development aid”, or “ODA”. Throughout the 1980s and up until the early 2000s, Japan provided large ODA loans and grants to China to promote infrastructure growth and technology sharing.⁷³ According to the Japanese Ministry of Foreign Affairs, over 3.3 trillion yen was given in ODA loans to China during this time.⁷⁴ While this aid is not technically considered “investment”, it laid the groundwork for future Japanese investment in China. In his 2005 study, Severine Blaise explained the link between Japanese ODA and FDI in China by saying, “one could expect ODA to

⁷² Herbener, Jeffery M. “The Rise and Fall of the Japanese Miracle”, Mises Institute, 20 September 1999.

⁷³ Pilling, David and Richard McGregor, “Japan Says to End Development Aid to China”, Financial Times, 17 March 2005.

⁷⁴ Ministry of Foreign Affairs of Japan, “Overview of Official Development Aid (ODA) to China”, 1 February 2016.

contribute substantially to the economic growth of a recipient country not only through its direct impact, but also indirectly by promoting the inflows of FDI.”⁷⁵

In fact, Blaise’s finding seems to be true: Japanese ODA in China bolstered Japanese investment in China, especially in areas where ODA was directed, which included much of China’s coastal regions.⁷⁶ Between 1989 and 2013 China held the position of “most promising destination of Japanese FDI”.⁷⁷ Between the Japanese External Trade Organization’s first year of counting Japanese FDI in China, 1987, and 2015, Japanese FDI has increased from millions to billions of US Dollars annually. These same statistics show that Japanese FDI in China has been fairly steady since 2000, until 2013 (see: “Figure 5”).⁷⁸ There is no denying that Japan has a long history of investment in China. There is also no denying that Japanese investors have put a lot of money into their Chinese investments, but something changed the status of Japanese investment in China in 2013.

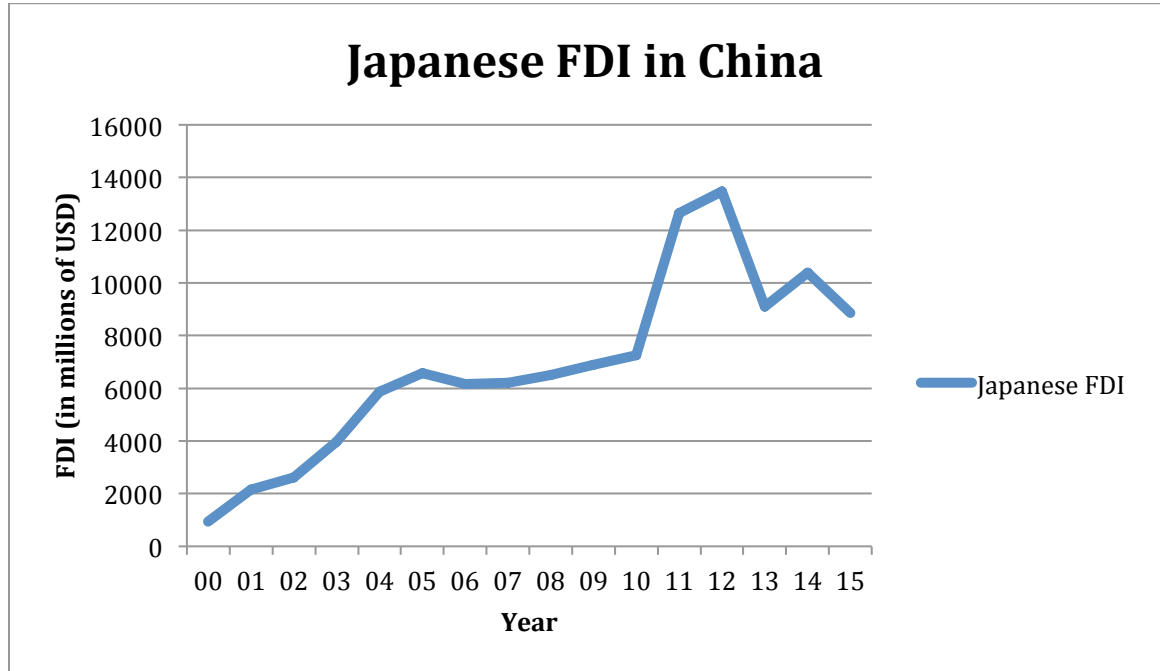
⁷⁵ Blaise, Severine, “On the link between Japanese ODA and FDI in China”, *Applied Economics*, 2005: 37, p. 52.

⁷⁶ Ibid. 54.

⁷⁷ Tanimoto, Masayuki, “JBIC Survey: China Is No Longer the Most Promising Destination for Japanese FDI”, Center for Strategic and International Studies, 5 February 2014.

⁷⁸ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 1987-2015.

Figure 5: Japanese FDI in China: 2000-2015⁷⁹



Japanese Investment Leaves China

The decline of Japanese investment in China is an interesting case as it differs in pattern from the decline of Sino-Japanese trade following the 2012-2013 Senkaku/Diaoyu dispute. The nationalist protests and subsequent boycott of Japanese goods in China led to an immediate change in trade, but by nature of investment, the decline of Japanese investment in China was not seen as immediately as the change in trade. This delayed reaction may have been due in part to a number of variables, but most likely the fact that the dispute did not come to the forefront of bilateral relations until late 2012 and the fact that the decision to leave the Chinese market may have been a reaction to the protests and decline in trade are strong contenders for why investment did not appear to be affected until the final numbers for 2013 were released.

⁷⁹ Ibid.

Looking purely at the numbers, October 2012 saw a 32% decrease in Japanese FDI compared to October 2011.⁸⁰ According to JETRO, Japanese FDI in China declined from about \$13.5 billion in 2012 to \$9.1 billion in 2013.⁸¹ In order to exclude the possibility that Japan may have been witnessing some general economic decline in 2012 and 2013 that would affect its foreign direct investment, it is important to note that Japanese FDI in Thailand increased from \$547 million in 2012 to \$10.1 billion in 2013.⁸² This trend continued in the United States, where Japanese FDI increased from \$31.9 billion to \$43.7 billion in the same period.⁸³ Of course, there were regions other than China that saw declines in Japanese FDI between 2012 and 2013, but none that came with the same coincidental circumstances that led to the decline of Japanese FDI in a country that had previously been named the most desirable location for Japanese investment.⁸⁴

What led to the exodus of Japanese investors from China? The simple answer would be “the 2012-2013 Senkaku/Diaoyu dispute”, but that ignores the events and rhetoric that followed the dispute. Thus far, the nationalist sentiment in China that led to a decline in trade has been explored extensively, but the reaction of Japan has not been explored as deeply. Japanese reactions to the 2012-2013 dispute can be broken down in two ways: 1. political rhetoric and 2. concerns of Japanese businessmen. Both types of reactions supported the decline in Japanese FDI in China.

Looking first at political rhetoric, there is no question that Japanese politicians took a stronger, more nationalist stance following the 2012-2013 Senkaku/Diaoyu

⁸⁰ Reilly, “A Wave to Worry About?”, 214.

⁸¹ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 1987-2015.

⁸² Ibid.

⁸³ Ibid.

⁸⁴ Tanimoto, “JBIC Survey”.

dispute. The action of nationalizing the islands, regardless of intent, was a nationalist decision within itself. The difference between China and Japan following the dispute, however, is that Japan did not experience mass protests, but Japanese politicians, especially the more conservative politicians who tend to hold nationalist views, did make statements condemning China and supporting Japanese national interests. In an interview in early 2013, Japanese Prime Minister Abe condemned China's use of intimidation against its neighbors and threatened that China could lose Japanese and other foreign investment if China did not change course.⁸⁵ This kind of rhetoric is not at all uncommon from a hawkish Japanese politician, but it does help further the understanding of how nationalist sentiment presents itself in Japan and how that nationalist sentiment connects the political to the economic, and in this case the Senkaku/Diaoyu dispute to the decline in Japanese FDI in China in 2013.

The second type of reaction, the concerns of Japanese businessmen, is more directly related to the nationalist sentiment of Chinese citizens and the influence that nationalism has over the desire of other countries' citizens to invest in China. In the same survey that showed that as of 2013, China is no longer the most promising destination for Japanese FDI, a change in Japanese feelings toward the security and stability of Chinese markets occurred. Prior to 2012, only about 10% of Japanese respondents cited "security/social instability" as their most serious concern in investing in China. This number was relatively stable. After the 2012-2013 dispute and subsequent protests, that number increased to nearly 32%.⁸⁶ One survey is not necessarily an absolute indicator of Japanese investment in China, but it does explain the concerns of Japanese investors

⁸⁵ Baker, "China Tests Japanese and U.S. Patience", 1.

⁸⁶ Tanimoto, "JBIC Survey".

following the 2012-2013 dispute and why those investors may have decided to leave the Chinese market in search of other, more stable markets.

Ramifications of the Disruption of FDI

In the previous chapter, a decline in economic stability and mutual trust were discussed as side effects of a decrease in bilateral trade, but nowhere is a decline in economic stability and mutual trust more evident than in a decrease in investment. In this case, the exodus of Japanese investors from the Chinese market led to more than a simple implication of distrust in Chinese markets. Japanese investors expressly stated that security and social instability were concerns that led to them leaving.⁸⁷ This level of distrust in Chinese markets had two key ramifications. The first is that a decline in Japanese investment in China led to an increase in Japanese investment elsewhere. The second is that a decline in Japanese FDI in China, like the disruption of trade, sets the mark higher for reactions of effective nationalist sentiment during the next dispute.

It is natural for most investors to look for stable markets in which to invest. When a market can no longer provide the stability an investor seeks, it is understandable that that investor should choose to find a more stable market. Wars, riots, mass protests, and general distrust in the populace of a country can all become the form of instability an investor feels makes investing in a particular country insecure. When a war, riot, mass protest, or distrust is specifically directed at the investor's own country, the investor may feel it is necessary to look for other investment options. After the nationalist, anti-Japanese protests in China in 2012, many Japanese investors felt this way. Their trust in

⁸⁷ Ibid.

the Chinese market had diminished, and Chinese trust in Japanese institutions diminished. In turn, Japanese investors took the hostile Chinese consumers as a sign to look for new markets, or invest more in already friendly markets. As previously mentioned, in the same period in which Japanese investment in China declined, Japanese investment in places like Thailand and the United States increased (see: “Figure 6”).⁸⁸ The increase in investment in places like Thailand, Vietnam, the Philippines, and the United States was enough to offset the decrease in investment in China and enough to make Indonesia the most promising destination for Japanese investment, followed by China (2nd), Thailand (3rd), and Vietnam (5th), according to Japanese investors surveyed in 2013.⁸⁹ The trend away from China’s rising labor costs was already in pushing Japan toward investment in ASEAN countries where costs are lower, but many point out that the political tensions and destruction of Japanese production sites during nationalist protests in China acted as a catalyst in the decision to leave.⁹⁰ Since then, India has moved up to be the most promising destination for Japanese investment.⁹¹ In both cases, it is important to note that China is no longer the most promising destination.

Although the decrease in FDI follows a different pattern than that of trade, it does create ripples in scale of effective nationalist sentiment. In the case of trade disruption, the key evidence that had to be looked at was the immediate effectiveness of a boycott on Japanese exports to China. Investment works a little differently. In the case of Japanese investment in China, we can still say that the nationalist protests in China in 2012 were

⁸⁸ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 1987-2015.

⁸⁹ Tanimoto, “JBIC Survey”.

⁹⁰ Zou, Cornelia, “Japan shifts more investment to ASEAN in strategic rebalancing”, China Daily, 1 September 2014.

⁹¹ Japanese Bank for International Cooperation (JBIC), “Survey Report on Overseas Business Operations for Japanese Manufacturing Companies”, December 2016, p.3.

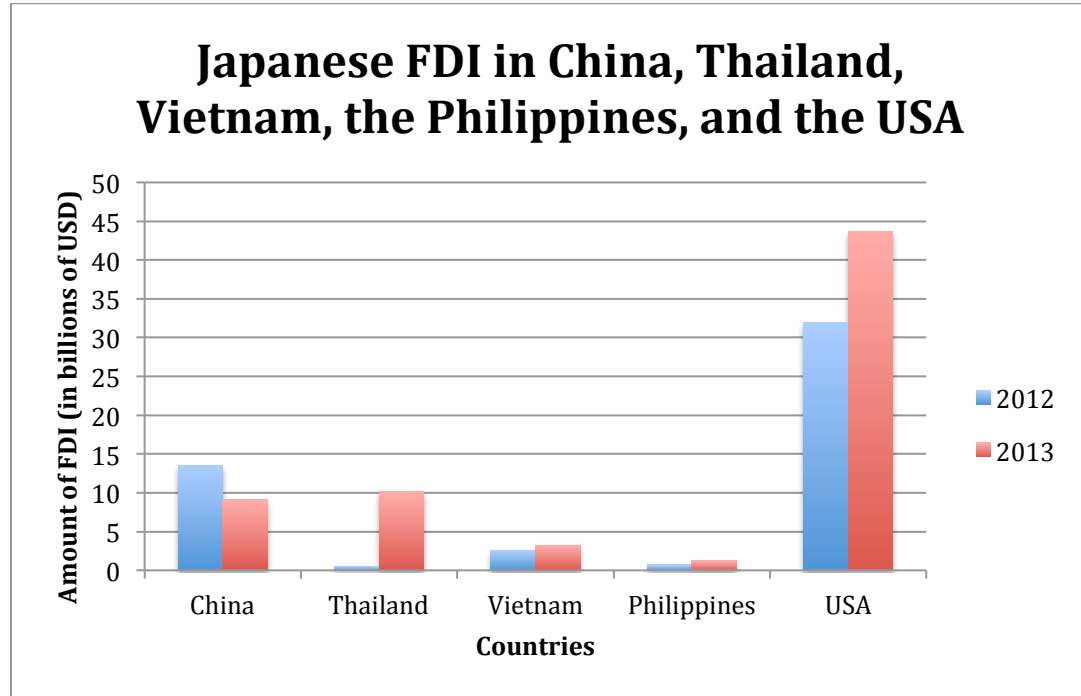
effective in disrupting Japanese investments, but we can also add Japanese nationalist sentiment into the scale of effective nationalist sentiment. Part of the micro level nationalist sentiment present in 2012-2013 is displayed as a chain reaction from the Chinese side: Japanese nationalization of the islands, Chinese protests, Chinese consumer boycotts, Japanese doubts in Chinese market reliability increase, Japanese investors leave the Chinese market.

The second part of the micro level nationalism present in 2012-2013 comes from the Japanese side. As previously discussed, Japan differs from China in how nationalism is displayed. In China, mass protests occurred. In Japan, while some people may have protested China's claim to the territory, there was not a mass protest or mass consumer boycott of Chinese goods. Instead, Japan saw stronger language from nationalist politicians who responded to Chinese protests with economic threats, condemnation of Chinese policy, and strengthening of national defense mechanisms.⁹² In the case of Japanese nationalist sentiment following the 2012-2013 dispute, the connection to politics was clear. Even if just political rhetoric to energize his base, Prime Minister Abe actively threatened China with a decline in Japanese investment and the benefits that come with all of Japan's investment.⁹³ A prime minister of a country warning another country that investment will drop drastically if circumstances persist connects political tensions, via nationalist sentiment, to a decline in economic relations.

⁹² Baker, "China Tests Japanese and U.S. Patience", 1-6.

⁹³ Ibid., 3.

Figure 6: Japanese FDI in Five Countries in 2012 & 2013⁹⁴



Return to “Normal”?

There still remains a question of whether there was ever a return to normal for Japanese FDI in China. It should be noted that, as of 2015, Japanese investment in China had not yet returned to pre-2013 levels.⁹⁵ Investment did bounce back in 2014 from its 2013 drop off, but not to its pre-2013 levels. Despite the fact that 2015 had an even lower level of FDI than 2013, it should not be taken to mean that the island issue was still a driving force behind Japan’s lack of investment in China. Looking at the available statistics from JETRO, Japanese investment in most countries declined in 2015, implying

⁹⁴ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”, 1987-2015.

⁹⁵ Ibid.

that there was likely an external event, unrelated to the Senkaku/Diaoyu problem, driving investment downward in 2015.⁹⁶

Where does this leave the state of Japanese investment in China? Like trade, we can probably expect to find a “new normal” in investment. The growth of Japanese FDI in Southeast Asian countries implies that Japan is definitely reaching out to other countries, and for good reason given that production in many Southeast Asian countries is cheaper than China.⁹⁷ Furthermore, according to the 2016 Japanese Bank for International Cooperation (JBIC) survey of Japanese business outlooks overseas, China dropped from third to fourth place in the eyes of most mid-tier businesses in terms of promising prospects over the next 3 years.⁹⁸ This differs from total outlook, however, in that total outlook places China in second place because large corporations’ survey responses are factored into the response. The trend of note is that mid-tier businesses have been lowering their prospects for China every year since 2012.⁹⁹ This may be because smaller businesses have a harder time mitigating their losses after nationalist protests than large multinational corporations. Although multinationals and other large corporations may be able to rebound after a nationalist protest or boycott (as many major Japanese automobile companies did), smaller Japanese firms cannot necessarily do so. Although smaller, these types of firms often appear in large numbers, which means that their lowered prospects could have deep long-term implications. This outlook implies that major corporations may continue business as usual after political tensions, but the proverbial “little guy” may not.

⁹⁶ Ibid.

⁹⁷ Tanimoto, “JBIC Survey”.

⁹⁸ JBIC, “Survey Report on Overseas Business Operation”, 21.

⁹⁹ Ibid.

One key factor that implies “normalcy” may return to Japanese FDI in China is that the number of businesses who cited “security/social instability” as their primary concern in investing in China declined in 2016.¹⁰⁰ This is the one promising factor that may allow for a return to relative normalcy in this one aspect of Sino-Japanese economic relations. In the 2013 survey, “security/social instability” spiked as a concern.¹⁰¹ This concern lasted through the 2014 and 2015 surveys, but in the 2016 survey, this concern dropped from the fifth most pressing concern to the tenth.¹⁰² Although the percentage of those who view security and instability as a primary concern remains relatively high compared to the pre-2012 numbers, it is nowhere near as high as the 2013 statistics. However, if we factor in the nationalist wave theory, this decline in concern over nationalist sentiment-induced security risks years after a triggering event is normal, but we can expect to see it spike again when the next big event occurs and nationalist sentiment is fueled yet again.

¹⁰⁰ Ibid., 27.

¹⁰¹ Tanimoto, “JBIC Survey”.

¹⁰² JBIC, “Survey Report on Overseas Business Operations”, 27.

Conclusion

Short-Term vs. Long-Term Implications

In order to truly comprehend the effects of the Senkaku/Diaoyu dispute on Sino-Japanese economic relations, the short-term and long-term implications must be weighed and compared. For the sake of this thesis, “short-term” will include anything within a year or two of the initial event. “Long-term” is a little more difficult to analyze, but in this case will include anything after five years following the initial event. The long-term implications are much more difficult to consider because, at the time of this writing, five years has not fully passed since the 2012-2013 conflict. In this case, we will use what we know of nationalist sentiment and what we know of mid-term trends to discuss long-term implications.

The short-term implications of the dispute are undoubtedly more intense and significantly more measurable than the medium-term or long-term implications. Looking at the data from 2013, there is no way to deny that there were sharp declines in key sectors of trade and in FDI.¹⁰³ This short-term period represents the swell of the nationalist wave formed of nationalist reaction in public opinions. The dispute is still fresh in everyone’s mind at one year, nationalist opinions still run high, and anger and frustration are still present. It is also the period of time in which the two governments have the least amount of formal contact. All considered, this leads to the implication that in the short-term, political tension has a strong effect on economics, proving that separated political and economic spheres based on a hot/cold binary is far too simplistic.

In the year following the 2012 nationalization of the Senkaku/Diaoyu Islands, many questioned the possibility of armed conflict between Japan and China. Although it

¹⁰³ Japan External Trade Organization (JETRO), “Japanese Trade and Investment Statistics”.

has been generally accepted that neither Japan nor China would really want to enter into armed conflict over small rocks in the East China Sea, this fear was primarily based in the lack of communication between the Chinese and Japanese governments at the time (frozen politics) and the fear that some secondary event may occur that, due to the lack of communication, would create an the environment necessary for armed conflict.¹⁰⁴ As much as economics had been hurt in the short-term, it served as a preventative measure for further conflict. In the short-term, economic relations suffered, but did not disappear completely. One factor that is seen as an indicator that China and Japan could witness armed conflict is “government-sponsored nationalist activism”.¹⁰⁵ In the case of the 2012-2013 Senkaku/Diaoyu dispute, Chinese micro level nationalist sentiment was a popular reaction within the macro level nationalism framework, but the Chinese government took certain measures to prevent nationalism from exceeding levels that would present dangers domestically. This is important to note, because it shows that one political action prevented a more intense conflict.

As stated previously, long-term implications of the dispute are much more difficult to judge because they have not happened yet. Using medium-term data and our knowledge of the nationalist wave theory, we can adequately determine some of the long-term implications of the dispute. First, looking at the medium-term trends, despite the fact that Sino-Japanese trade seems to be rebounding, it also appears that Japan has been diversifying its trade partners and investment recipients. There are a number of factors at play over why Japan may be taking such measures, but it is important to note that this trend of seeking out other economic relations appears predominately in 2013 and

¹⁰⁴ Smith, Sheila A., “A Sino-Japanese Clash in the East China Sea”, Council on Foreign Relations, April 2013.

¹⁰⁵ Ibid.

continues through the medium-term. If these trends are anything to go on, then many Japanese firms seem to prepare for the possibility that another 2012 could happen again. And sure enough, if the nationalist wave theory remains true, which we assume it does given that it seems to have adequately characterized the nationalist reactions to the Senkaku/Diaoyu dispute in the past, then rebounds in certain sectors and a decline in micro level nationalist sentiment in the medium- to long-term are not unusual at all. The wave has to crash at some point. The medium-term represents that crash. The long-term implication then is that as the wave is receding, another unforeseen event, with a basis in long-term nationalism could occur that starts the cycle of volatile short-term nationalist sentiment anew.

In the sense that the long-term holds two possibilities, implications must be viewed as such. The first possibility is that after five or more years, China and Japan do not experience another clash over the Senkaku/Diaoyu Islands and the mid-term trends continue to develop. The second possibility is that after five or more years, China and Japan do experience another clash over the Senkaku/Diaoyu Islands and the medium-term trends are contextualized. The first instance still holds that Sino-Japanese economic relations improve, despite the fact that Japan may continue to seek other trade and investment partners. The first possibility is also highly unlikely. It is much more likely that after five years or more, China and Japan will encounter another conflict at the islands. In this case, the diversification of Japanese trade and investment is contextualized: it is a protective measure. The diversification in this case also serves to distance the Japanese and Chinese economies. Any economic rebounds occurring in that time will likely disappear as a new cycle of micro level nationalism begins, this time with

a higher reaction start value than before because these short-term nationalist incidents have built off previous incidents, including the 2012-2013 dispute. The only promising feature of this long-term possibility is that presumably the event would have to be bigger or of equal shock value as Japanese nationalization of the islands. At this time, it is impossible to say what that event might be, but very likely it would have to involve the loss of life, extensive militarization of the islands, or some other shock.¹⁰⁶

The Veracity of “Cold Politics, Hot Economics”

Throughout this thesis, there has remained a question of what the effects of political tension on economics means for the “cold politics, hot economics” binary. The 2012-2013 dispute shows that politics and economics cannot be viewed as completely separate spheres in Sino-Japanese relations. Understanding this, the best way to view “cold politics, hot economics” going forward is as a characterization that once may have been accurate, but now presents a far too simplistic binary view of a complex issue that incorporates political effects on economics through nationalist sentiment. Because of the dual nature of the causal mechanism “nationalist sentiment”, it is impossible to say that nationalism presents itself as a binary. If the causal mechanism cannot be presented as a binary, then it reduces the possibility that the two relationships it connects can be defined as simply.

While “cold politics” appears to be a fairly good description of Sino-Japanese political relations at this time, it fails to account for the volatility and complexity of political relations. Because the connection between politics and economics has been adequately made through nationalist sentiment, economics now functions in a similarly

¹⁰⁶ Ibid.

volatile and complex manner. Nationalist sentiment is not something to be taken lightly. If 2012-2013 exemplified anything it is that nationalist sentiment can be highly effective and a highly persuasive force in politics and economics. Within the short-term, micro level nationalist sentiment following a political dispute based in macro level nationalism definitely caused a cooling of economics, and under the nationalist wave theory a deeper cooling should occur with the next big event. This means that 2012-2013 reached the threshold that Davis and Meunier mentioned as the level of political tension needed to affect economics.¹⁰⁷ The effect of a territorial dispute that was formerly a strictly political event, through nationalist sentiment, managed to change the economic relationship of Japan and China enough that it has laid the foundation for a different characterization of Sino-Japanese relations.

¹⁰⁷ Davis and Meunier, “Business as Usual”, 34.

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